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Supreme Court of the United States

OCTOBER TERM, 1941.

No. 825.

IN THE MATTER

of

THE REORGANIZATION OF THE ELEVENTH WARD BUILDING AND LOAN ASSOCIATION OF NEWARK, NEW JERSEY.

REPLY BRIEF OF PETITIONERS.

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REPLY BRIEF OF PETITIONERS IN SUPPORT OF PETITION FOR WRIT OF *CERTIORARI*.

A.

Statement.

The New Jersey statute here involved (Petitioners' main brief, App., p. 15, *et seq.*) designates the Commissioner of Banking and Insurance of New Jersey as an "aggrieved" person for the purposes of appeal from any order made by the Court of Chancery approving or disapproving a plan of reorganization. R. S. 17:12-106 (Petitioners' main brief, App., p. 17). For that reason, service of the petition for Writ of *Certiorari* and of the petitioners' brief in support thereof, was made upon the Commissioner of Banking and Insurance (hereinafter called the Commissioner) as well as upon the respondent Association. Both the Commissioner and the Association have filed briefs.

This brief will reply to both briefs under one cover, to eliminate the use of an extra book by the Court.

I.

Both briefs emphasize the fact that the petitioners have investments of about $258,000 out of an aggregate investment in the Association of $8,488,182; that the petitioners represent 1.59% of the total number of shareholders, and 3.05% of the total monies invested.

The argument on the amount of money invested by the petitioners in comparison to the total sums invested, seeks to prejudice the petitioners. It is immaterial.

The statute (Petitioners' main brief, App., p. 16) imposes the duty of active dissent upon members of the Association. It requires that the dissent be served upon the Association, and filed in the Court of Chancery at least five days before the date of the meeting of members called to consider and vote upon the Plan. The Record discloses that the Association deluged its members with copies of the Plan, "follow-up" letters (R. pp. 121, 122), proxies (R. pp. 118-121) and requests to return proxies (R. pp. 69-70). The Plan is an intricate, technical, and highly complex document. The average small investor could not be expected readily to understand the workings of the Plan and all its implications. The average small investor, noticing a call for a meeting, would naturally be disposed to suspend his judgment on the Plan until the meeting. If he did nothing and attended the meeting in search of information, he would find that, if he objected to any part of the Plan, it would be too late to make an effective dissent. His vote at the meeting would be futile.

Small investors are entitled to their day in court. In *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, Mr. Justice Douglas said (at p. 115):

> "Hence, in this case the fact that 92.81% in amount of the bonds, 99.75% of the Class A stock and 90% of the Class B stock have approved the plan is as immaterial on the basic issue of its fairness as is the fact that petitioners own only $18,500 face amount of a large bond issue."

The emphasis laid, by the Commissioner and by the Association, upon comparative investments is immaterial. It is part of the coercion to which the petitioners were subjected in the courts below. The Court of Chancery said (R. p. 127, l. 35, *et seq.*):

> "Counsel for the Association reiterates that the Plan of Reorganization has been approved by the Commissioner of Banking and Insurance, and representatives of the Reconstruction Finance Corporation, the Federal Home Loan Bank and the Federal Savings and Loan Insurance Corporation as well as by the Board of Directors and an impressive majority of the shareholders of the Eleventh Ward Building and Loan Association."

The Court of Errors and Appeals said (R. p. 260, ll. 27-32):

> "In determining whether the proposal is 'fair' and 'equitable' in this behalf, it is not without significance that appellants comprise 1.57% of the total membership, and represent but 3.05% of the share liability of the association."

The same oppression is evidenced by the emphasis laid in the courts below, and again laid here by the Commis-

sioner and the Association, that the Plan is the result of the combined "efforts" of the Commissioner, the New Jersey Building and Loan League, the Federal Savings and Loan Insurance Corporation, the Federal Home Loan Bank of New York, and the Reconstruction Finance Corporation. At every step in this case, the petitioners have been faced with the obvious attempt on the part of the Commissioner and the Association to impress the courts with the array of institutions whose judgment is sought to be imposed upon the petitioners. The petitioners object to being involuntary and forcibly inarticulate guinea pigs for the "experiments" of the Federal Home Loan Bank of New York, the Reconstruction Finance Corporation, the Federal Savings and Loan Insurance Corporation, and the Commissioner. If they are to be guinea pigs, they want their day in court and the opportunity to submit, for the serious consideration of the court, material in opposition to the arguments advanced by these agencies. The will of the majority as determined by their "experiments" should not be forced upon the minority simply because of the difference in numbers and the weight of the combined federal and state agencies. Submission to coercion is not the application of fair and equitable standards. The petitioners object to the paternalism of the agencies which created a formula, of which they, the petitioners, had no notice, and in the concoction of which they had no voice. They seek to be protected against any incursion of their right not to be "benefited" against their will. They feel that they do not have to be told what to do with their money. By right of might and by means unwarranted and oppressive, the Association and the Commissioner seek to defeat the rights of minority members. This is their last appeal for relief.

Since holders of securities issued by building and loan associations are excluded from the benefits of the Securities Act of 1933, 48 Stat. 74, any financial transaction of the magnitude here involved, proposed by the managers of a building and loan association, should have the protection, for minority members as well as majority members, of the most careful scrutiny of the court charged with the duty of determining the fair and equitable treatment of all the investors affected. The petitioners did not get that scrutiny in the courts of New Jersey.

II.

The Commissioner argues that building and loan associations are *quasi-public* institutions affected with a public interest. This is true, but beside the point.

The petitioners do not deny the validity of the well-established rule that constitutional guarantees must yield to proper exercise of the reserved power of the state. In every case like that here presented, there are two inquiries:

(1) Is the statute constitutional;

(2) Are its provisions constitutionally applied?
Treigle v. *Acme Homestead Association,* 297 U. S. 189.

Both questions must be affirmatively answered before the validity of the Plan is established.

It has been held that the legislature may lawfully alter withdrawal privileges;

Bucsi v. *Longworth Building & Loan Association,* 119 N. J. L. 120;

Rocker v. *Cardinal Building and Loan Association*, 119 N. J. L. 134;
Veix v. *Sixth Ward Building and Loan Association*, 310 U. S. 32;
Sommer v. *Workingmen's Building and Loan Association*, 17 N. J. Mis. R. 267, affirmed 125 N. J. L. 83.

These cases all go on the ground that it is competent for the legislature to control withdrawal demands to prevent ruinous liquidation of building and loan association assets through forced sales. There can be no quarrel with either the result or the reasoning.

It is one thing, however, to conserve assets from forced liquidation, and it is an entirely different thing to provide the means for continuance of business for all purposes. The first purpose is a public one; the latter purpose is not. There is no connection between the two.

There is no proof that reorganization is the sole alternative to "forced" liquidation. As a matter of fact, the cases cited above have made the "forced" liquidation of a building and loan association a virtual impossibility in New Jersey. There is no proof that anything deleterious would happen to the State of New Jersey, the people of New Jersey, the members of the respondent Association, or to anybody, if the respondent did not reorganize. There is no proof that anything would happen if the respondent Association did nothing by way of reorganization or liquidation. The respondent Association had not closed its doors; it had not suspended business; it was managing its own affairs.

It is not necessary to the economic life of the state that it have *new* building and loan associations. They do not perform the functions of banks. They achieve the status of corporations affected with a public interest simply because of the magnitude of the combined funds invested in them, and not because of any peculiar public function exercised by them. They are convenient instrumentalities, but not essential ones, like insurance companies or banks. The petitioners offered proof (R. pp. 140, 250, 251) that those associations now functioning in Newark, New Jersey, are having difficulty in finding safe outlets for investment. The petitioners offered proof that Newark, New Jersey, the community in which the Association is located, is already adequately serviced by other institutions which perform a like service (R. pp. 140, 251). The courts below refused to listen to these offers.

It is a mixed question of law and fact whether a statute is in fact enacted for a public end. In *Treigle* v. *Acme Homestead Association, supra,* this Court said:

> "But laws touching building and loan associations, like those affecting banks or utility companies, must be confined to purposes reasonably connected with the public interest as distinguished from purely private rights. The legislature has no greater power to interfere with the private contracts of such corporations, or the vested rights of their stockholders as such, under the pretext of public necessity, than it would have to attempt the same ends in the case of a private corporation. Though the obligations of contract must yield to a proper exercise of the police power, and vested rights cannot inhibit the proper exertion of the power, *it must be exercised for an end which is in fact public and the means adopted must*

be reasonably adapted to the accomplishment of that end and must not be arbitrary or oppressive." (Italics supplied.)

The petitioners were denied the right to prove the fact that the statute was not enacted for an end which was in fact public. They were denied the right to introduce evidence to prove that the provisions of the statute were not applied in a manner to achieve an end which was in fact public (R. p. 138).

III.

The Commissioner's argument that building and loan associations are subject to the police power begs the basic question.

The Commissioner relies upon *Veix* v. *Sixth Ward Building and Loan Association, supra; Treigle* v. *Acme Homestead Association, supra,* and *Bucsi* v. *Longworth Building and Loan Association, supra,* as conclusive evidence that building and loan associations are subject to the police power and may be reasonably regulated and controlled by legislative action. *The statute in question is not a statute enacted to regulate building and loan associations.* It was enacted to create *new* associations.

The statute here attacked belongs to that class of legislation which is constitutional only if it has a factual basis justifying it. Where that factual basis is challenged, a proper case for judicial inquiry is made out.

United States v. *Carolene Products Co.*, 304 U. S. 144;
Borden's Farm Products Co. v. *Baldwin*, 293 U. S. 194.

The petitioners did not get a judicial inquiry. They offered to prove (R. p. 140) that *new* "reorganized" associations in New Jersey have loaned their funds to persons who are only technically members; they do not share in profits nor do they participate in losses. They offered to show that the funds of the *new* reorganized associations are for the most part not realized from contributions made by members but are derived from loans made by governmental or other agencies. They offered to show (R. pp. 140, 141) that *new* reorganized building and loan associations are unable to invest their funds in mortgage loans in a normal manner and that they have been driven to wholesale purchase of mortgages from other corporations. They are artificially created and artificially stimulated by huge loans. Their operation is such that now there are virtually no differences between building and loan associations and private money-lending institutions. Once again the argument revolves around the offer of the petitioners, made and denied below, to introduce evidence below to determine whether the statute was enacted for a public end and whether public or only private rights were involved. Their offer was denied.

IV.

Both the Commissioner and the Association argue that the petitioners were given a hearing; the record refutes the argument.

Both briefs point to the fact that an order allowing proofs was entered (R. pp. 138, 141). The same order denied the petitioners leave to submit the proofs. The order denied, in the first instance, the right of the petitioners to *attempt to introduce* the proof. This is different from a ruling on the admissibility of evidence.

The refusal of a court to receive or consider any proof whatever on the subject amounts to a denial of a hearing on that issue, in contravention of the due process of law clause of the Constitution.

> *Georgia Railway & Electric Co.* v. *Decatur*, 295 U. S. 165, 171;
> *Morgan* v. *United States*, 298 U. S. 468;
> *Baltimore and Ohio Railroad Co.* v. *United States*, 298 U. S. 349.

Ordinarily rulings on the admissibility of evidence are concededly not subject to review by this Court. Here the matter was not one of admissibility of evidence but on the right to prove a case.

It is clear from the order referred to, and from the opinion of the Court of Errors and Appeals, that both the Court of Chancery and the Court of Errors and Appeals did not consider inquiry into the questions raised as being the subject of proof. Both courts begged the very question of the right of inquiry. This is not due process.

The limited proofs permitted did not constitute the full hearing required by the due process clause. No judge, no referee, no special master, no agent of the court listened to the evidence. The court did not rule on any question of evidence as to the proofs which were taken; the court did not dispose of the objections made. This was not due process. Due process requires a full hearing which is the *hearing of evidence* and argument.

V.

Both the Commissioner and the Association argue that the petitioners had a hearing because certain testimony was taken. The Record discloses that the hearing was a limited one and not before the court, or judge, or referee, or special master, or examiner.

The testimony printed on pages 218-242 of the Record was not given before the court (Vice-Chancellor Bigelow) or any judge or special master. Counsel for the Commissioner said (R. p. 219, ll. 25-35):

> "* * * I, in behalf of the Commissioner, and with Mr. Stickel concurring in behalf of the Eleventh Ward Building and Loan Association, suggested to the Court it is quite probable that Mr. Eisenberg would wish to cross examine the affiants, and if that was the case we had no objection. Whereupon the Vice-Chancellor said that was quite alright. There is no order of the Court directing that the affiants be cross examined. It is a voluntary act on behalf of counsel."

The testimony printed on pages 157-187 of the Record was not given before the Court (Vice-Chancellor Bigelow) or any person designated by him. There were numerous objections made to the testimony throughout. These objections were never ruled upon by the Court.

VI.

The Commissioner and the Association argue that the statute and the plan in providing for the crediting of book value to borrowing members without a similar treatment to

non-borrowing members does not violate the 14th Amendment. Their briefs admit the preferential and discriminatory treatment given borrowing members.

The Association argues (Association's Brief, Point B, pp. 8, 9) that "The constitution and by-laws of the Association authorized the directors to allow such a credit * * *" also that "Were the borrowing members to be given a credit of but 45% the extent to which the petitioners would be affected would be $1,052.27, a cheap price indeed for the compensating benefits of the plan". This is an admission of fact.

The Commissioner's argument is (Commissioner's Brief, p. 5) that "The crediting of full share values in reduction of mortgage loans in such reorganization is common practice and regarded as good financing". The Association's argument (Association's Brief, p. 9) is that "Here is not a preference but rather the agreement by the Association to grant a credit * * *". While the Commissioner and the Association both admit the fact, both deny the preference; one for the reason that it is "common practice" and the other by the statement that it is not a "preference" but rather the "agreement by the Association to grant a credit". Thus we have an admission that members of the Association were treated differently; the members who owed money to the Association on mortgages received full credit for their dues paid; the petitioners who were non-borrowing members received credit of but 45% of their dues paid in.

Such a preference in a proper case may be unobjectionable. It is objectionable, however, where it has no rational

basis. Such a basis is lacking here. It is concededly arbitrary (R. p. 171, ll. 13-27). It is conceded in the briefs here. It is invalid in the statute and it is invalid in the Plan.

Conclusion.

It is respectfully submitted that this Honorable Court should exercise its power to preserve to the petitioners their rights under the Constitution of the United States.

Respectfully submitted,

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